

STATE OF CALIFORNIA

ELECTRICITY OVERSIGHT BOARD

PUBLIC MEETING

FRIDAY, DECEMBER 8, 2000

CALIFORNIA STATE CAPITOL

ROOM 126

SACRAMENTO, CALIFORNIA

10:00 A.M.

REPORTED BY:

SANDRA VON HAENEL  
CSR No. 11407

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APPEARANCES

ELECTRICITY OVERSIGHT BOARD MEMBERS:

Mr. Michael A. Kahn, Chairman  
Senator Debra Bowen  
Mr. Bruce G. Willison  
Assemblyman Roderick D. Wright

ELECTRICITY OVERSIGHT BOARD STAFF:

Mr. Gary C. Heath, Executive Director  
Mr. Erik N. Saltmarsh, Chief Counsel  
Ms. C. Catherine George, Staff Counsel

OTHERS PRESENT:

Mr. Rod Campbell  
Mr. John Rozsa  
Mr. Lawrence Lingbloom  
Mr. Richard Jacobs  
Ms. Lynn Miller  
Mr. Charles Robinson  
Mr. Randy Abernathy  
Mr. William Regan  
Mr. Phil Leiber  
Ms. Angali Sheffrin

1                               SACRAMENTO, CALIFORNIA  
2                               FRIDAY, DECEMBER 8, 2000, 10:00 A.M.

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4               CHAIRMAN KAHN:  Let's get started.  Senator Bowen is  
5   just outside, and she will be joining us.  And we have a  
6   representative from Assemblyman Wright's office,  
7   Rod Campbell.

8               Do you want to come on up?  You're welcome to join us.

9               My name is Michael Kahn, and I am the chairman of the  
10   Electricity Oversight Board, and this is a regular meeting  
11   of the Electricity Oversight Board.

12              I'd like to make a couple of introductory remarks, and  
13   then I'm going to invite the representative of  
14   Assemblyman Wright, and Senator Bowen herself, to make a  
15   comment if they wish.

16              And my colleague, Bruce Willison, the Dean of the  
17   Anderson Business School, who is an EOB member, and he is to  
18   my right.

19              I also welcome Mr. Rozsa from Senator Peace's office.  
20   Thank you for joining us this morning.

21              I'd like to make two introductory remarks or  
22   observations.  One, obviously, this has been a very  
23   difficult December.  We have a situation in which we went  
24   into a Stage 3 yesterday and which is obviously  
25   extraordinary.

1           There are many concerns in terms of the reliability  
2   issues, but I think an enormous concern here is the prices.  
3   And one thing is absolutely clear: the people of the state  
4   of California are paying prices for electricity, either  
5   directly or indirectly through institutions, that are  
6   literally obscene, and we need to address that issue, and  
7   I'm sure it will be addressed.

8           The second thing I wanted to mention is the following:  
9   We at the Electricity Oversight Board have an obligation to  
10   oversee the ISO. And I think that there is a lot of noise  
11   and a lot of criticism of things that the ISO is doing. But  
12   I think that one thing is overlooked about what the ISO is  
13   doing, and that is keeping the lights on. Yesterday and the  
14   day before and the day before were extremely difficult days  
15   for the ISO, and many, many, many extremely hardworking men  
16   and women are working to keep the lights on, and have done  
17   so successfully.

18          And I think in this process we forget that there is  
19   hard and productive and, obviously, at this point,  
20   successful work done by ISO people that we would be remiss  
21   in our duty. So, on behalf of the Electricity Oversight  
22   Board, I would hope that the ISO representatives here would  
23   communicate to the staff who is working so hard and so ably  
24   in keeping the lights on, that we do understand these  
25   efforts are being made, and we appreciate them.

1           And it's a situation where the other problems are  
2   getting the attention, but no one should be disabused of the  
3   notion -- or no one should have the notion that we do not  
4   understand the hard work being done by ISO employees to keep  
5   the lights on. We can only, on behalf of the Electricity  
6   Oversight Board, ask that you keep up that work. It's  
7   obviously essential.

8           I think the citizens of the state of California have  
9   performed wonderfully in bringing down their use of energy,  
10   and the state government has made a big effort in reducing  
11   demand. And with those efforts at reducing demand, and with  
12   the efforts of the ISO in coordinating what electricity we  
13   have, hopefully we will be able to avoid any more burden on  
14   the citizens than we've felt thus far.

15           With that, I'm going to invite my colleague,  
16   Mr. Willison, to make any opening remarks.

17           MR. WILLISON: No. That was well spoken. Thank you.

18           CHAIRMAN KAHN: Mr. Campbell, on behalf of Assemblyman  
19   Wright would you like to make an opening remark?

20           MR. CAMPBELL: Not at this time.

21           CHAIRMAN KAHN: Thank you. Mr. Rozsa?

22           MR. ROZSA: No, thank you.

23           CHAIRMAN KAHN: Then we will proceed with the agenda,  
24   and Senator Bowen, when she arrives, we'll invite her to  
25   make opening remarks if she wishes.

1           We have a management report.

2           Before that, we have approval of the minutes.

3           MR. HEATH: That's correct.

4           CHAIRMAN KAHN: The minutes have been distributed and

5 posted on the website?

6           MR. HEATH: Yes.

7           CHAIRMAN KAHN: Do we have a motion?

8           MR. WILLISON: Yes. Move the approval of the minutes.

9           CHAIRMAN KAHN: Second.

10          All in favor?

11          THE MEMBERS: Aye.

12          CHAIRMAN KAHN: That carries two to nothing.

13          The minutes are approved.

14          Now, our management report.

15          MR. HEATH: Very good. Thank you, Mr. Chairman,

16 member. We will try to keep the management report to sort

17 of the high points.

18          In your binders you will see we have our latest hiring

19 plan. I'm happy to announce that we will have the principal

20 departments coming on board at the end of next week. We

21 also have office staff on for our staff counsel positions,

22 and which we hope will be filled shortly. That is

23 progressing actually within our plan for this calendar year

24 to fill those positions.

25          As you can see in your binders, we are moving as

1 quickly as we possibly can, with the restraints we have, to  
2 fill those positions.

3       The next part of our report I want to bring to your  
4 attention was some of the activities that the EOB itself has  
5 engaged in in support of the Governor's Clean Energy Green  
6 Team. Obviously, in the housing of the Green Team in the  
7 EOB offices, we are providing not only legal support and  
8 clerical administrative support to the Green Team, but also  
9 freeing up our engineering folks and economists to work with  
10 the Green Team director on various projects. It's an  
11 ongoing effort, and it certainly continues to be a high  
12 priority for the EOB staff to support the Green Team's  
13 efforts.

14       CHAIRMAN KAHN: I would like to make a public comment  
15 on that. The Governor asked me to head the Green Team. It  
16 was another thing I didn't volunteer for, and when he did  
17 so, I immediately asked the EOB and Mr. Heath to provide  
18 administrative and other assistance. As you probably know,  
19 Mr. Heath, at the Green Team meeting a week ago, it was  
20 announced that all the Green Team statutory obligations have  
21 been fulfilled and that we are now moving on to other issues  
22 related to providing generation in the state.

23       There is no question that none of that could have been  
24 done without you and your staff, and I want to express my  
25 gratitude for all the hard work that you did. I think the

1 Green Team effort is an unprecedented one in the state of  
2 California as well as a successful beginning. But you and  
3 your folks really deserve the lion's share of the credit,  
4 folks. So congratulations on that.

5 MR. HEATH: Thank you very much, Mr. Chairman. I  
6 appreciate those kind words.

7 CHAIRMAN KAHN: I think what I'll do at this moment,  
8 then, is introduce Senator Bowen, and invite her to make  
9 opening remarks if she wishes.

10 Senator, I began the meeting by making the observation  
11 that two things are worth noting. One is that we have a  
12 crisis not only in terms of reliability, but prices, and  
13 that pricing is obscene, and we have got to address the  
14 pricing issues.

15 The second observation I made is that all of us in  
16 California owe the hardworking men and women at the ISO a  
17 debt of gratitude for causing the lights to stay on despite  
18 the fact that we have very limited resources due to facts  
19 that we are investigating. But that doesn't take away the  
20 gratitude we owe the ISO and the people.

21 And with that, we open the meeting. But I would like  
22 to introduce Senator Bowen, head of the Utilities Committee  
23 of the Senate and other responsibilities.

24 SENATOR BOWEN: Thank you. I would just like to say  
25 that we also owe some thanks to Governor Davis for turning



1 off the pumps in the state aqueduct in order to keep our  
2 businesses and residences from having rolling blackouts, and  
3 I think we need a lot more of that kind of leadership from  
4 state government. We do use a lot of power ourselves, and  
5 we need to be looking at our own office buildings and asking  
6 whether every worker needs to be able to read the Wall  
7 Street Journal and the Sacramento Bee in every stairwell in  
8 every state office building, or whether there is another  
9 lighting level that might provide adequate security and use  
10 less energy.

11           So I'm looking forward to the state being leaders in  
12 the effort, that conservation. That's the most immediate  
13 way to help with prices.

14           CHAIRMAN KAHN: Thank you. For the audience, we, in  
15 the Green Team meeting, the State of California did, in  
16 fact, report on the efforts that have been undertaken under  
17 Governor Davis's leadership. I believe the number was 180  
18 megawatts. Is that right?

19           MR. HEATH: There was about 180 within a sector --  
20 250. And we're working on that.

21           CHAIRMAN KAHN: So we have specific goals. And, once  
22 again, the headlines talk about the potential problems and  
23 the disasters, but what they don't do is take into account  
24 literally thousands of state employees who have been turning  
25 off lights and turning off computers and taking other

1 actions, and we are measuring the effects. We are also  
2 encouraging the federal government to participate in that  
3 program because they are an enormous user of electricity in  
4 our state.

5 Mr. Heath, we were doing the management report?

6 MR. HEATH: Yes, and I'll continue it. Thank you.

7 Mr. Chairman, members, the next item that I wanted to  
8 report on was the current status of the budget augmentations  
9 for fiscal 2001-2002. We've had a number of meetings and  
10 rounds of meetings with Finance and the Administration on  
11 that. As it currently stands, the proposals that you  
12 approved at our meeting, I believe, back in August, those  
13 remain intact and we're moving forward with those, and we  
14 will be before the various legislative committees, hopefully  
15 beginning first of the year.

16 I would like to say one more thing on that. These  
17 recommendations to move forward with that are coming from  
18 the Department of Finance. The Administration still has to  
19 give the final blessing on that before it's included in the  
20 Governor's budget, but we're very happy to hear that we'll  
21 get those augmentations that we think we need.

22 The next item on the agenda is that I believe you have  
23 a handout. We just wanted to do a very brief report on  
24 electricity prices and loads and natural gas prices.

25 Mr. Chairman, you've already mentioned about those

1 skyrocketing prices. We just wanted to show you, beginning  
2 from December 1 to December 7 basically what it's looking  
3 like in terms of those loads, the prices of electricity, and  
4 as now important to us certainly, the price of gas. I'm  
5 going to apologize a bit on the gas one, because I think  
6 that our numbers may be now even lower, unfortunately, than  
7 what has been reported in the trade press this morning,  
8 where we are seeing \$53 for a million BTU.

9           So, in our report as of the 7th, it was around 37.  
10 So, as you can see from that report, things are continuing  
11 to spiral upward and, I guess, out of control.

12           So that concludes the management report at this time.

13           CHAIRMAN KAHN: Mr. Heath, there is one question that  
14 comes up frequently in the hearings that I go to and  
15 testify, and that is the correlation between natural gas  
16 prices and our electricity prices and how much of the rises  
17 in our electricity prices are due to natural gas.

18           Perhaps for the next meeting, or even between  
19 meetings, the staff could address that issue in a way so  
20 that legislative members and the other members could have  
21 that information. It would be very helpful.

22           MR. HEATH: We'd be happy to provide that to you,  
23 Mr. Chairman. We'll provide a report on that, and we'll  
24 post the report on our web page.

25           CHAIRMAN KAHN: Thank you very much.

1           Can I ask, Gary, if there is evidence that any  
2   generation has been pulled off line because it has become  
3   uneconomical with these gas prices?

4           MR. HEATH: We are hearing that, and that is still  
5   part of sort of our ongoing investigation as to the rise of  
6   the emergencies that have occurred since the 1st of this  
7   month and in November. We do not have concrete information  
8   of data on that one, but it is being pursued as one of the  
9   issues. We are hearing from generators -- and this is sort  
10  of the side conversations -- that, yes, gas prices are, in  
11  fact, part of the decision making to not generate or to  
12  generate.

13          Associated with that a little bit is the air emission  
14  credits and the price of those credits. And that, we're  
15  also seeing, is part of the judgment that the generators are  
16  making in terms of can they afford the credits, can they  
17  afford the gas and make a profit at the same time and  
18  continue to operate. So those are major issues that we're  
19  looking at. I will be happy to include that number in our  
20  report as to air emission credits, because it is now another  
21  factor that we have to take into consideration.

22          MR. WILLISON: Then there has been no movement to  
23  provide relief on those emission credits?

24          MR. HEATH: There is, and it has been somewhat on a  
25  selected basis. As you are aware, it has been reported that

1   there has been approximately 2500 megawatts off in the  
2   Southern California area due to a couple of issues. One  
3   that you mentioned was the air-credit issue, and one is the  
4   availability and running out of those credits at this time,  
5   and plus the cost of gas.

6           We have been -- I believe that the California ISO has  
7   been pursuing, I think, contracts with those generators to  
8   help recover those costs. They are actually quite critical  
9   to maintaining reliability and stability of the system,  
10   particularly in the Southern California area.

11           There's a very active set of negotiations going on.  
12   We think they are so successful at this point that, while  
13   they have not been concluded, we believe that AS is  
14   beginning to actually ramp up its units in Southern  
15   California and should be on-line or to meet -- or at least  
16   part of that on-line to meet the peak this afternoon, which  
17   will be around 5:00, 5:30. And that will be around 700  
18   megawatts. The remaining megawatts should be coming  
19   on-line.

20           Another important feature associated with those  
21   contracts is that they're going to be environmentally  
22   dispatched, basically, the cleanest ones first and the  
23   dirtiest ones last. That's our understanding.

24           We've been in discussions with the South Coast and  
25   with the ISO on this matter. We will be getting into

1 contracts, and I can make those available to the members if  
2 they so wish, the terms and conditions related to those  
3 contracts.

4 MR. WILLISON: Thank you.

5 CHAIRMAN KAHN: Thank you very much. I'd like to  
6 welcome Mr. Lingbloom of Senator Bowen's staff.

7 Mr. Heath, where are we?

8 MR. HEATH: I think I finished the management report,  
9 and I'll ask Mr. Saltmarsh if there's anything in the  
10 General Counsel's report.

11 MR. SALTMARSH: Good morning, members. My report  
12 should be quite brief today unless you have extensive  
13 questions.

14 There were two items I wanted to note to the Board.  
15 There is a document included in your package which is a  
16 subpoena from the Electricity Oversight Board to the  
17 Independent System Operator. This reflects the Electricity  
18 Oversight Board's continuing efforts to obtain data and  
19 investigate circumstances related to the summer of 2000 and  
20 thereafter reliability and pricing issues. We are carrying  
21 out these information gathering efforts and analytical  
22 efforts in continuing the coordination with both the Public  
23 Utilities Commission and the Attorney General's Office.

24 There have been some additional recent meetings with  
25 those two institutions, and I anticipate reporting to you in

1 the relatively near future some work plans and joint effort  
2 proposals that we may have on going to the next phases of  
3 that. I've provided you with this document to let you know  
4 what our most recent requests for data are.

5 The second item that I was going to bring to your  
6 attention is in relation to the Governor's Clean Energy  
7 Green Team. At the last meeting of the Green Team, one of  
8 the Green Team members suggested that it would be beneficial  
9 for the Green Team to get a report that basically discusses  
10 known constraints in the transmission system and weaknesses  
11 in the California transmission system that might benefit  
12 from some short-term efforts to undertake upgrades.

13 It was suggested that the Electricity Oversight Board  
14 work with the ISO to produce some report to the Green Team  
15 from the ISO. At that time President Lynch noted that under  
16 the provisions of recently enacted legislation, the Public  
17 Utilities Commission is working with the Electricity  
18 Oversight Board on a very similar effort.

19 And so we are coordinating now with the staff of the  
20 Public Utilities Commission to produce the material that is  
21 available under the joint PUC-EOB investigation of  
22 transmission limitations and constraints, and are going to  
23 work with the ISO to augment that to the extent the ISO can  
24 produce additional material. And we're trying to get that  
25 to the Green Team as soon as possible in the form of a

1 report.

2 CHAIRMAN KAHN: Okay. I'll look forward to that, too.

3 I'd like to welcome Assemblyman Wright.

4 Would you like to make an opening comment?

5 ASSEMBLYMAN WRIGHT: No. I think I'm catching the

6 sequence. It would be redundant to say something that has

7 already been said three or four times.

8 CHAIRMAN KAHN: Okay. Mr. Heath?

9 MR. HEATH: I think I concluded the reports from the

10 management side, and we're ready to move into the first

11 action item on today's agenda. And I'll ask

12 Catherine George of our staff to come forward, and

13 Mr. Jacobs from the ISO is ready to make a presentation in

14 regard to amendment to the Articles of Incorporation.

15 MS. GEORGE: Good morning, Chairman Kahn and members

16 of the Electricity Oversight Board and guests.

17 The item you have before you is an action item

18 requested by the ISO. The ISO Governing Board, in

19 September, voted to amend their Articles of Incorporation in

20 a manner in which they have been advised they will be able

21 to qualify for property tax exemptions from the State.

22 The amendment requires Electricity Oversight Board

23 approval. As is indicated in the staff report, EOB staff

24 recommends that you approve the amendment. I believe that

25 the memo in your report is largely self-explanatory, but I



1 do have one update for you.

2 The ISO has had further opportunity to look at the  
3 question of the need to file this amendment with the Federal  
4 Energy Regulatory Commission and has determined that they  
5 are not required to file the amendment with the FERC.

6 CHAIRMAN KAHN: You anticipated my question. Thank  
7 you.

8 MS. GEORGE: Therefore, if the Board were to approve  
9 this amendment, I could advise that the ISO would go ahead  
10 and submit the amended Articles to the Board of Equalization  
11 in anticipation of seeking a property tax refund of  
12 approximately \$900,000.

13 CHAIRMAN KAHN: What's the economical impact of this?

14 MS. GEORGE: Currently it's about \$300,000 per year,  
15 and they would seek a refund -- Mr. Jacobs can correct me if  
16 I'm mistaken -- but a refund for two years and the year  
17 2000, so a total amount of about \$900,000, and then going  
18 forward with California BOE exemption in the future.

19 CHAIRMAN KAHN: Mr. Jacobs, welcome. Do you have any  
20 comments?

21 MR. JACOBS: I don't. I'd be happy to answer any  
22 questions if you have any.

23 CHAIRMAN KAHN: The numbers Ms. George articulated are  
24 correct?

25 MR. JACOBS: Those are correct.

1           CHAIRMAN KAHN: Is there any discussion of this  
2 amendment?

3           SENATOR BOWEN: I have just one question.

4           CHAIRMAN KAHN: Sure.

5           SENATOR BOWEN: Now, there have been a number of news  
6 reports about Edison's and PG&E's efforts to have certain of  
7 their facilities exempted from property taxes or to have  
8 reductions in the property tax paid to counties. This is  
9 unrelated to that; is that correct? This totally has to do  
10 with the nonprofit status?

11          MS. GEORGE: That's my understanding, yes.

12          SENATOR BOWEN: There will be no essential adverse  
13 effect on the proceedings with regards to property tax on  
14 facilities?

15          MS. GEORGE: Not that I'm aware of. We can take a  
16 look at that if you would like us to confirm.

17          MR. SALTMARSH: That is totally my understanding. The  
18 investment utility efforts relate to some rule  
19 reclassifications that they would like to have happen. This  
20 matter that the ISO is bringing forth is a long-standing  
21 rule relating to property tax of nonprofit facilities.

22          CHAIRMAN KAHN: Okay. Any discussion?

23          Seeing none, make a motion.

24          MR. WILLISON: Move approval of the amendment.

25          CHAIRMAN KAHN: Second.

1           Any discussion? All in favor?

2           THE MEMBERS: Aye.

3           CHAIRMAN KAHN: Seeing no opposition, passes two to

4 nothing.

5           MS. GEORGE: Thank you.

6           MR. JACOBS: Thank you.

7           CHAIRMAN KAHN: Mr. Heath, where are we now?

8           MR. HEATH: We are on Item No. 5, CalPX and ISO

9 reports.

10          Mr. Chairman, members, you will recall for weeks we've

11 been trying to get before this Board current financial

12 status and current proposed budgets for calendar year 2000

13 for both the ISO and PX corporations. I would like to see

14 if we can move through these rather quickly today. I think

15 it would be important for the Board to have a brief

16 presentation from each of the corporations as to their

17 current financial status and current proposed budgets for

18 next year, and then take any questions from the Board

19 members in regard to those budgets.

20          In your package you have a memo that apparently covers

21 the California ISO and some issues that we had raised there.

22 But maybe limited presentations first, and then further

23 questions if you have them.

24          CHAIRMAN KAHN: Thank you. Do you want to start with

25 the PX?

1           MR. HEATH: I do indeed. Lynn Miller is here. Lynn  
2 has been up to Sacramento a number of times, and we're  
3 trying to get her up on the stand.

4           CHAIRMAN KAHN: Would you introduce yourself, please.

5           MS. MILLER: Yes. My name is Lynn Miller. I'm the  
6 Chief Financial Officer and Controller of the California  
7 Power Exchange.

8           CHAIRMAN KAHN: Welcome, and thank you for your  
9 patience.

10          MS. MILLER: Thank you.

11          CHAIRMAN KAHN: Go ahead.

12          MS. MILLER: I believe that you have two handouts.  
13 One is the handout which is the financial report that I  
14 present to the Finance Committee of the PX and its Board  
15 every month when they meet. The information in there,  
16 unless you have questions on it, I think is pretty  
17 self-explanatory. It's basically a balance sheet.

18          I would call your attention to the Item Slide No. 5,  
19 which is on Page 3, I believe, of your handouts, where we're  
20 looking at the PX is still ahead of its budget in terms of  
21 revenues. And predominantly that comes from the fact that  
22 when we budget for revenues, we budget for a normal summer,  
23 and, as you know, this year has been anything but normal.

24          And so unless you have any specific questions of PX as  
25 it relates to its funding, I think I'll move on to the

1 budget.

2 CHAIRMAN KAHN: Seeing none.

3 MS. MILLER: Okay. The second handout, that is,  
4 again, the budget that I presented to the Finance Committee  
5 of the California Power Exchange, and I think it's pending  
6 approval in December. This also leads into, then, our  
7 filing with the Federal Energy Regulatory Commission as to  
8 our rate that we will charge for our services in the  
9 upcoming year.

10 And Page -- Slide No. 3 is basically a summary of  
11 that. Our core fee for doing work for the markets providing  
12 the auction service is 30.64 per megawatt hour. That has  
13 not changed since we started up the PX. We have maintained  
14 that fee at the same level since we started in April of '98.

15 Our increase in operating expenses is a little bit  
16 over last year's budget, and part of that is due to the  
17 development areas that we are going into in trying to expand  
18 the auction services for use of the costs that we have and  
19 spread them over more residents.

20 Our head count is totally right now at about 133. The  
21 budget -- we're slightly below that right now. Our capital  
22 spending is the major item in our budget for next year.  
23 It's 17 million, which is higher than it has been in  
24 previous years. The 17 million is predominantly for making  
25 changes in connection with what the ISO proposes to do in

1     this marketplace. So as they make changes in their system,  
2     we must make similar changes to keep up with them.

3             CHAIRMAN KAHN: Can you elaborate a little more fully  
4     on what \$17 million is going to?

5             MS. MILLER: Sure. If you would turn to the Slide  
6     No. 13. I'm sorry. 12 and 13.

7             CHAIRMAN KAHN: 11.

8             MS. MILLER: 11, 12, and 13, you can see the breakdown  
9     of how the 17 million is broken down. I'm referring to the  
10    slide numbers that are in the pages.

11            For the core budget there is 8 million of the 17 for  
12    ISO regulatory changes that we would have to make to keep  
13    our systems in pace with their changes that they will be  
14    making.

15            CHAIRMAN KAHN: I don't mean to be thick, but what  
16    does that mean?

17            MS. MILLER: Well, it means that the ISO makes changes  
18    to their systems. Because we take the information from them  
19    to bill our customers, we must make likewise changes in our  
20    systems to be able to --

21            CHAIRMAN KAHN: Are you talking about software?

22            MS. MILLER: Software, yes, sir.

23            CHAIRMAN KAHN: So this is \$8 million in software?

24            MS. MILLER: Software and hardware changes that would  
25    have to come as a result of changes being made, proposed by

1 the ISO in their system.

2 CHAIRMAN KAHN: What's the distribution between  
3 software and hardware costs?

4 MS. MILLER: This is mostly software costs.

5 CHAIRMAN KAHN: Okay.

6 MS. MILLER: Do we have a question here?

7 CHAIRMAN KAHN: Do you have a question?

8 ASSEMBLYMAN WRIGHT: Yes, please.

9 The \$30 a megawatt hour for operations, how does that  
10 compare with other forms of system management?

11 MS. MILLER: System management in what way?

12 ASSEMBLYMAN WRIGHT: I mean, there are a number of  
13 places around the country that do a similar function that  
14 you do. How does the \$30 that you're charging compare with,  
15 say, Chicago or PJM or New York or whatever?

16 MS. MILLER: I find that very difficult to compare,  
17 because there is no one exactly like the PX in those other  
18 areas you have combined ISO and PX function in the same  
19 location. And we are running an auction market that is  
20 unique in the country right now to that perspective.

21 ASSEMBLYMAN WRIGHT: I mean, it's difficult when you  
22 say the \$30. It's kind of oblique, because I don't have  
23 anything to compare it to. I mean, there is a song that  
24 they play in my neighborhood that -- the name of the song is  
25 "Compared to What?" And so if you say \$30, I don't know

1    what \$30 compares to, so it's difficult to say whether or  
2    not that makes good sense or bad sense, because I don't know  
3    what it's relative to.

4           I mean, I've heard discussions from other parts of the  
5    country that \$30 is exorbitant. But, again, since I don't  
6    have anything to compare to, I'm kind of taking a pig in a  
7    poke.

8           MS. MILLER: Okay. Let me explain it this way. When  
9    we filed this tariff with the Federal Energy Regulatory  
10   Commission, because we are a public utility and have to file  
11   our rates with them, the design structure of our prices of  
12   our administrative fee was done to accommodate, basically,  
13   the investment in utilities in California. This fee is only  
14   paid by the buyers.

15          If you look at comparable exchanges, such as the  
16   obligated power exchanges or others who may not be doing the  
17   full gamut of services that we provide, they will more than  
18   likely charge both sides of distribution, charging both  
19   buyers and sellers. So we don't really have anything that's  
20   unique, like we are, in order to compare. Our services  
21   include the trading function. They also include the  
22   scheduling and delivery function, which most other entities  
23   that do exchange work do not do. It also includes credit  
24   management and collection function. Ours right now is a  
25   bundled price. So for 30.64 per megawatt hour, you get all



1 three of those services combined.

2 ASSEMBLYMAN WRIGHT: But at some point, Mr. Chairman  
3 -- and it might be worthwhile to break out those costs and  
4 attempt to ascertain what the relative value is of each cost  
5 and whether or not it makes good sense. I mean, depending  
6 on who you ask, it's not a good deal. It may well be that  
7 it is good, but I think one of the things that we kind of do  
8 see -- I mean, 30.64 for a megawatt hour. I mean, compared  
9 to what? Is that good, or bad? Should it be 15? Should it  
10 be 20? Should it be 40? I don't know that it's good or  
11 bad.

12 CHAIRMAN KAHN: Well, Assemblyman, I think the time to  
13 do that is now. And so I'm going to ask Mr. Heath to do  
14 it --

15 ASSEMBLYMAN WRIGHT: Okay.

16 CHAIRMAN KAHN: -- and respond to the Assemblyman's  
17 questions.

18 ASSEMBLYMAN WRIGHT: If what we are talking about is  
19 the present rate, then I think the issue would be to try to  
20 isolate the costs we're paying within the bundle and then  
21 compare those services to people who perform similar  
22 services in other parts of the country, so that you could  
23 ascertain whether or not 30.64 makes good sense. I think we  
24 accept at face value that it is.

25 I'm not saying that it's good or bad at this juncture,

1 but there are people in the country who say that it's  
2 exorbitant. And when you ask them, they say the same thing  
3 that the witness just said, that it's difficult to compare,  
4 because you're not comparing apples to apples. So,  
5 therefore, we accept at face value a number that doesn't  
6 have anything upon which we're able to have an adequate  
7 measure. I just think that's a difficult environment for us  
8 in which to play.

9 CHAIRMAN KAHN: I think you're entirely correct, and  
10 we will take steps to get that information.

11 Yes, absolutely.

12 SENATOR BOWEN: The question that I'd like to add to  
13 that evaluation is what impact on the PX budget a move to  
14 significantly more bilateral contracting outside the PX,  
15 presumably to reduce volume going through the PX? And, of  
16 course, the concern is that because fixed costs are fixed,  
17 that you could actually end up at more than 30.64,  
18 significantly more if you move a lot of energy out of the PX  
19 into bilateral contracts.

20 I think that's something we ought to be thinking  
21 about.

22 ASSEMBLYMAN WRIGHT: I think so too.

23 CHAIRMAN KAHN: I agree with that. And that was an  
24 overall comment I was going to ask you to please pass on to  
25 the rest of your management. Needless to say, we are in a

1 fluid situation here, and the role that the PX is going to  
2 play in the future is not clear. And to the extent we don't  
3 have to spend money that we are going to deem later is not  
4 necessary, I think that would be prudent.

5 MS. MILLER: I understand.

6 CHAIRMAN KAHN: Okay. Any other questions?

7 Thank you very much for your report and your patience,  
8 again.

9 And then we'll turn to the ISO. Is that right;  
10 Mr. Heath?

11 MR. HEATH: That's correct, Mr. Chairman.

12 CHAIRMAN KAHN: Good morning, Mr. Robinson.

13 MR. ROBINSON: Good morning.

14 CHAIRMAN KAHN: Would you introduce yourself and your  
15 colleagues, please.

16 MR. ROBINSON: Certainly. My name is Charles  
17 Robinson. I'm the Vice President and General Counsel of the  
18 ISO. And this is Randy Abernathy, who is our Vice President  
19 of Human Resources.

20 This is Bill Regan, who is our CFO. And Phil Leiber,  
21 who is our Treasurer.

22 SENATOR BOWEN: Could we have the last name. I've  
23 lost the detail.

24 MR. REGAN: Regan, R-e-g-a-n. And Leiber,  
25 L-e-i-b-e-r.

1           SENATOR BOWEN: Thank you.

2           CHAIRMAN KAHN: How would you like to do this,

3 Mr. Robinson?

4           MR. ROBINSON: If you'd like to start with the budget

5 report.

6           Mr. Regan.

7           MR. REGAN: Thank you, Mr. Kahn.

8           Chairman, members, yes, we have passed out a summary

9 sheet of the report of financials to date. We'd like to

10 spend a few moments going over financial results to date,

11 then we'll address the fiscal year 2001 budget, and then the

12 impact of that fiscal 2001 budget on the rate structure for

13 the ISO which, in fact, beginning on January 1, 2001, will

14 be unbundled into separate components, service components

15 provided by the ISO. If you would flip just to the first

16 page.

17           SENATOR BOWEN: May I ask a preliminary question?

18           MR. REGAN: Yes, ma'am.

19           SENATOR BOWEN: The budget that you're presenting has

20 been approved by the ISO Board?

21           MR. REGAN: Yes, ma'am, it has.

22           The first page, Page 1, summary of the budget

23 highlights, results to date for 2000, we are looking at

24 results through the end of October, ten months. Operating

25 revenues for the year, for the first ten months,

1     \$158 million, compared to the budget of \$152 million. The  
2     operating revenues are, in fact -- the grid management  
3     charge is collected at the rate of 83 cents per megawatt  
4     hour delivered power.

5             Operating expenses are budgeted for the first ten  
6     months at \$111,900,000. Actual expenditures to date:  
7     \$108,790,000, 3 million under budget.

8             Capital expenditures budgeted at -- projected for  
9     the first ten months at \$16 million. We've actually spent  
10    some \$28 million. The total budget for the full year is  
11    just about \$40 million, and we are projected to be in line  
12    with that. I should note that the budget number that  
13    shows capital expenditures of \$49 million includes some  
14    \$7,250,000 for the purchase of land and \$2 million for  
15    development of the land, development expenses associated  
16    with that land.

17            CHAIRMAN KAHN: For what purpose?

18            MR. REGAN: This is for the purpose of constructing an  
19    office building for the ISO.

20            MR. WILLISON: And could I ask you just to remind us,  
21    what are the big pieces? You know, take away the land, some  
22    \$40 million capital expenditure.

23            MR. REGAN: It is primarily software development, sir.  
24    And Phil is the budget officer, and I think Phil could speak  
25    more closely to the components of that.

1           MR. LEIBER: Yes. Bill's comment was correct. It's  
2 almost entirely computer software. There are other items,  
3 such as IT equipment. That is relatively minor. There are  
4 some enhancements to our current facility, but 90  
5 percent-plus of our budget for the past three years in  
6 capital expenditures has been essentially customized  
7 computer software.

8           MR. WILLISON: To do what?

9           MR. LEIBER: Run our markets, provide for the  
10 reliability, systems necessary to operate the grid.

11          CHAIRMAN KAHN: Do you have the breakdown between grid  
12 operation and market operation?

13          MR. LEIBER: We do have that. I've got a pie chart  
14 for our proposed 2001 capital expenditures. It's not in  
15 here. In the past, I would say reliability spending has  
16 probably been about one-third of the total. Spending on  
17 market changes and enhancement facilities have been about  
18 two-thirds.

19          MR. REGAN: The final item on the budget to date,  
20 revenue requirement. Our revenue requirement is the actual  
21 money required to meet all of our obligations. To date, our  
22 revenue requirement has been \$145,395,000, which is a budget  
23 of 150 million, suggesting that we are actually, all in,  
24 \$5 million under budget for the year.

25          We are projecting for the full year we will come in

1 total revenue requirement with our total projecting on  
2 budget, within a hundred to two hundred thousand of budget.

3 I would like now to go to the 2001 budget time line,  
4 just to give you some insight as to what we have gone  
5 through in developing the 2001 budget. It has been an  
6 ongoing effort at the ISO, though it was formalized this  
7 past June as we kicked it off. We have gone through Budget  
8 Review of the budget. It was done in executive session on  
9 September 21st, and with their approval, the budget --  
10 proposed budget for 2001 proposed by ISO management, put on  
11 the website at the end of September. We had an open budget  
12 workshop on October 19th. We presented it once again to the  
13 Finance Committee of the Budget on October 26th, and then  
14 one more Finance Committee public session on November 13th.

15 Following that, the Board did review and approve the  
16 budget as recommended by management at its meeting on  
17 November 30th, and our next obligation is to file the budget  
18 with the FERC on December 15th.

19 If the Committee is willing, I would ask Mr. Leiber to  
20 now take you through the budget as proposed for fiscal year  
21 2001. And it has been approved by the ISO Board.

22 CHAIRMAN KAHN: Okay.

23 MR. LEIBER: If you will turn to Page 3. This is a  
24 high-level summary of the budget. The operating budget is  
25 showing a substantial increase of 29 percent from 2000-2001.

1 Approximately 6 percent of this increase is related to  
2 continuing to provide service at the same level we've been  
3 providing in the year 2000.

4 We've had a number of expenditures in 2000 that were  
5 not in the original budget. We've been able to offset some  
6 of those costs with savings elsewhere but to continue at the  
7 same level we're providing today.

8 SENATOR BOWEN: Can you tell us what the increases are  
9 and what the offsets are, please.

10 MR. LEIBER: Sure. Some of the increases are due to  
11 changes to our markets. For example, we've moved to a  
12 10-minute settlement system, which is a major cost-saving  
13 measure, we hope. Some of the other items are accelerated  
14 payment calendar, to provide payments to our suppliers on a  
15 more timely basis, to make California more competitive with  
16 other suppliers or with other regions in the western U.S.  
17 which do provide quicker payments.

18 Some of the offsets have included -- we had a fairly  
19 substantial increase in our staffing in 2000, and a number  
20 of those positions were slotted to be filled earlier in the  
21 year than they actually were. So we had some savings that  
22 were able to absorb some of the unforeseen expenses we  
23 incurred this year.

24 MR. WILLISON: So the almost 24 million, then, in  
25 operating costs for some of these new services are not just



1 one-time software expenses. They're actually ongoing  
2 operating costs?

3 MR. LEIBER: That's correct. A number of the changes  
4 that I mentioned, the 10-minute settlements, they require an  
5 up-front investment, and they also require an ongoing  
6 investment. For example, to lease the computer equipment on  
7 which the software runs, additional people to run and manage  
8 some of these programs.

9 In addition, the increase in the operating budget also  
10 provides for funding for next year for new programs that we  
11 are not currently providing. Approximately 40 percent of  
12 the total increase, or \$15 million, is for required changes  
13 we anticipate next year. For example, we intend to replace  
14 our energy management system. We have a system that's old  
15 and outdated. It doesn't provide the programs necessary to  
16 operate the grid on a reliable basis. That's going to  
17 require additional support costs for next year.

18 So, again, approximately \$15 million of this increase  
19 is for new requirements for next year.

20 SENATOR BOWEN: Can you tell me exactly what the  
21 energy management system does.

22 MR. LEIBER: This is the system that actually matches  
23 power supply and demand minute by minute. So it's looking  
24 at the load out there across the state, and it's pooling the  
25 generators to ensure that the two amounts are properly

1 managed.

2 SENATOR BOWEN: And that's not working adequately

3 right now?

4 MR. LEIBER: It's working, but not in the manner that

5 the operators, the people actually out on the floor, would

6 like to have it work. They're having to put in a lot more

7 time than in the past. When it's not a crisis situation as

8 we're seeing today, they can manage, but when you add the

9 deficiencies with that system with the short supply that

10 we're seeing today, it really substantially increases the

11 risk that something could go wrong, and it's not deemed to

12 be a viable situation to continue.

13 Moving on to the second line item, the financing

14 budget. We have a \$15 million increase here that's

15 explained really in just two ways. During 2000, we borrowed

16 additional money to make some of the software changes that

17 we have already made this year. That's about half of this.

18 The other half is for borrowing we need to make in 2001 to

19 continue our capital expenditure program.

20 Overall, our net revenue requirement --

21 SENATOR BOWEN: That's interest expense? What portion

22 is interest?

23 MR. LEIBER: It's interest and principal repayment.

24 Our interest costs are quite low. We are able to borrow at

25 a very favorable rate. As a not-for-profit entity, we can

1 use tax-exempt borrowing, so our cost of borrowing is in the  
2 four and a half percent range.

3 So the number that you see here includes interest  
4 costs of approximately 13 million, and the remainder is for  
5 repayment of those borrowings.

6 SENATOR BOWEN: Could you lay out in a little more  
7 detail what the capital expenditures are that are being  
8 repaid in 2001.

9 MR. LEIBER: Sure.

10 SENATOR BOWEN: There is a second capital expenditure  
11 budget line item down below it, and I need to know the  
12 difference between the financing budget and the capital  
13 expenditure budget.

14 MR. LEIBER: Sure. The capital budget is the money  
15 that we spend to change our system. We don't pay the full  
16 cost of those changes in the year they go into effect,  
17 because these system changes will provide benefits over many  
18 years. So what we do is we borrow the money to pay for the  
19 capital budget this year, pay it off over time.

20 So, in the financing budget of \$63 million, we have  
21 two pieces of expenditures. The first was we initially  
22 borrowed \$300 million to get the ISO up and running, and  
23 that debt is being paid off over ten years. And, in  
24 addition, we have next year's capital spending that has to  
25 be funded from bonds. And that money will be paid off over

1 five years.

2 SENATOR BOWEN: And how much is anticipated to be  
3 borrowed next year?

4 MR. LEIBER: To meet next year's capital spending  
5 requirements, we will borrow approximately \$35 million.

6 SENATOR BOWEN: And that's the amount that's in the  
7 financing budget line item, and then the 37,774 below that  
8 is in addition to that?

9 MR. LEIBER: No. They're really one and the same. We  
10 borrow the money in the capital expenditure budget, and we  
11 pay that off over time. And that appears in the financing  
12 budget.

13 The amount that we actually collect from our users in  
14 a given year is the third line down, net revenue  
15 requirement, which includes two items: the operating budget  
16 and the financing budget. The financing budget, as I  
17 mentioned, goes to pay for our capital expenditure program  
18 in any given year.

19 The net revenue requirement does increase by a total  
20 of \$46 million. It's essentially adding together the  
21 increase in the operating budget and the financing budget.  
22 It is offset to some extent because of a revenue credit.  
23 We, in the past three years, have actually collected a bit  
24 more than we need to actually fund our ongoing costs, and  
25 that has resulted in an operating reserve and a cushion for

1 rainy days. That reserve is full, and we therefore will be  
2 able to refund the excess as reduction in our revenue  
3 requirement for next year.

4 CHAIRMAN KAHN: When you say "users," do you mean the  
5 IOUs, or what do you mean?

6 MR. LEIBER: The users would be all the people who pay  
7 our grid-management charge. Ultimately, most of that is the  
8 IOUs. It would also include other suppliers and municipal  
9 entities.

10 SENATOR BOWEN: But ultimately ratepayers?

11 MR. LEIBER: Ultimately ratepayers, yes.

12 Just as a point of reference, this number looks quite  
13 large. It's not a small amount, but to put it in  
14 perspective, it represents approximately one half of a  
15 percent on an end user's bill. So it is a large number, but  
16 in the scheme of things, it's not quite as large as it might  
17 appear.

18 Again, just to summarize. The overall cost increase  
19 is really related to additional responsibilities that the  
20 ISO has undertaken. Our costs are not out of control.

21 SENATOR BOWEN: Can we clarify what you said.

22 MR. LEIBER: Sure.

23 SENATOR BOWEN: What amount is equivalent to half of a  
24 percent? The increase, the total operating budget?

25 MR. LEIBER: That's the total of the ISO cost. So if

1 we take that \$225 million a year and we parcel that out to  
2 all the energy across the state, it represents about a half  
3 percent on an end user's bill.

4 SENATOR BOWEN: Thank you.

5 MR. LEIBER: Just to summarize this. Our cost  
6 increase is related to additional responsibilities. We're  
7 not charging more for providing the same thing. One of the  
8 charts I found useful to explain this is if we chart our  
9 growth in revenue requirement against the number of things  
10 that we have been asked to do that weren't originally  
11 contemplated when we started in 1998, the lines track quite  
12 closely.

13 One concern that Assemblyman Wright mentioned I think  
14 it's very worthwhile for me to address is our costs in  
15 comparison to other providers across the country. It is  
16 something we very keenly look at. There are some notable  
17 differences. A number of those we can explain away. But at  
18 the end of the day, our costs are frankly somewhat higher  
19 than theirs.

20 A number of the things have to do with differences in  
21 our circumstances under which we started up. We were formed  
22 to operate very, very quickly. We paid a premium to do  
23 that. We also have somewhat of a more complex market  
24 structure than perhaps some of the other -- some of our  
25 peers out there.

1           We also have made additional investments in terms of  
2   reliability. We have a backup center. We have a very  
3   robust communications system. So there are a number of  
4   differences that do need to be taken into account, but at  
5   the end of the day, our costs are a bit higher than our  
6   peers. But it is something we continue to look very closely  
7   at. We meet periodically with the other ISOs to compare our  
8   budget to theirs and find better ways of doing things. So  
9   it is a concept in a program that we are very committed to.

10          If you turn to Page 4, you'll see that our cost  
11   increase from 2000 to 2001 is set forth here, and I think  
12   it's easiest just to view this as three categories. A third  
13   of this pie chart shows that our cost increase is due to  
14   debt service. We've borrowed money to fund our capital, and  
15   we have to repay that over time. That gets put into our  
16   rates. So that's about a third of our increase.

17          Another third is related to our staffing. We have our  
18   standard cost-of-living increase for people, and we also  
19   have the cost of additional staff we're bringing onboard.

20          The remaining third is for various costs. Our legal  
21   fees have been running substantially higher than what we had  
22   budgeted this year. We expect that trend to continue next  
23   year.

24          Building lease facility cost. Whenever we make  
25   changes to our computer systems, we typically lease the

1 equipment. We are adding a substantial number of new  
2 computers. That gets reflected here.

3 CHAIRMAN KAHN: Why are the legal expenses rising?

4 MR. LEIBER: We've just had a lot more to deal with.  
5 I think Charlie can best answer that question.

6 MR. ROBINSON: I think, as you're well aware, we are  
7 currently the subject of investigations by five different  
8 agencies, and we're participating, depending upon how you  
9 count them, in anywhere from seven to ten separate  
10 investigations or audits. That's a substantial part of the  
11 increase.

12 In addition to that, there is a great deal more  
13 regulatory activity, both at the federal level and the state  
14 level. We are receiving a number of ongoing requests for  
15 information and that sort of thing.

16 CHAIRMAN KAHN: You hire outside counsel to help you  
17 in the investigations?

18 MR. ROBINSON: Yes.

19 CHAIRMAN KAHN: Thank you.

20 MR. LEIBER: If there are no further questions on  
21 Page 4, I will flip over to Page 5. This just provides an  
22 additional detail, and I won't spend a tremendous amount of  
23 time unless there is a request to do so. But it does  
24 indicate that, on an ongoing basis, our costs have increased  
25 from 133 million up to 171 million for next year. That



1 shows the breakdown. The primary increase is in terms of  
2 salaries and benefits. This is primarily adding additional  
3 people. We have a budgeted head count this year of 452  
4 staff. Next year we foresee the need for 544 staff.

5 CHAIRMAN KAHN: The Assemblyman, I believe, has a  
6 question.

7 ASSEMBLYMAN WRIGHT: Understand I don't know the  
8 validity of this, and you'd probably be the best person to  
9 ask. Is there an issue relative to your current credit  
10 position in being able to pay the debts that you hold, for  
11 instance, concerns that you're approaching a credit limit or  
12 there may not be enough cash or you may need to increase  
13 your credit limit to ensure that you're able to meet  
14 obligations and cover debts?

15 MR. REGAN: Our current process, Assemblyman Wright,  
16 is that we are a conduit. We collect from the IOUs, from  
17 the load, and pass the money on directly to the generators.  
18 It is not the ISO's credit that would be in question. It  
19 would be the credit of the ultimate customer.

20 So to the extent that an individual generator is  
21 concerned about the amount of money that is owed, it is the  
22 money that is owed to them by load through the ISO, but it  
23 is not the ISO itself that is the obligor. But we are a  
24 conduit.

25 The real challenges come about from two sources. One

1 has been the tremendous increase in price over the past  
2 several months that has impacted the amount that is owed.  
3 Second, is because of the software involved. Because of the  
4 challenge in collecting information, it takes upwards of 70  
5 days for us to get the appropriate information to bill the  
6 IOUs or to bill the load and collect the money. So at any  
7 one point in time, the amount of money that is owed to the  
8 generators is some 70 days of electricity.

9 As electricity prices have gone up, the amount that is  
10 owed has gone up considerably. So the question is not  
11 whether the ISO has the credit standard. The credit  
12 standard of the ISO is, in fact, the creditworthiness of the  
13 load behind it.

14 ASSEMBLYMAN WRIGHT: What is that rate right now?

15 MR. REGAN: Right now it's a function of all the  
16 different -- primarily the IOUs. Somewhere in the  
17 neighborhood of 85 to 95 percent of the funds we collect  
18 come through the PX, which is almost entirely through the  
19 IOUs, so our IOUs. So our credit standards are essentially  
20 a summation of the credit standards of the individual IOUs.

21 ASSEMBLYMAN WRIGHT: I understand in their last  
22 solicitation, that one of the IOUs couldn't get all the  
23 money that they were trying to raise. Do you keep up with  
24 their --

25 MR. REGAN: I'm not aware of that situation at all.

1 Each month we send a bill out, and it comes in --

2 ASSEMBLYMAN WRIGHT: Different drill. I'm saying that

3 one of the IOUs in their last solicitation was not able to

4 raise all of the dollars that they sought.

5 MR. WILLISON: You mean like raising money from

6 capital markets?

7 ASSEMBLYMAN WRIGHT: Right. They went to the capital

8 market and didn't get all of the money that they sought, and

9 some of them are now carrying substantial debt. And I guess

10 it would be middle of January that they'll do an additional

11 filing which may push their credit ratings down further.

12 What impact would that have on you if their credit

13 ratings drop?

14 MR. REGAN: If their credit ratings drop, then our

15 ability to utilize their credit standards to generate -- to

16 solicit power over a 70-day period from load, from

17 generation, could, in fact, be compromised.

18 CHAIRMAN KAHN: What contingency do you keep if they

19 become insolvent?

20 MR. REGAN: We do not have any contingency except

21 their ability to pay.

22 CHAIRMAN KAHN: Do you consider that a possibility?

23 MR. REGAN: That is a very real possibility. That's

24 correct.

25 ASSEMBLYMAN WRIGHT: Wait a minute. You consider it a

1 possibility that they could be insolvent, and you don't have  
2 a plan as to what you do if they go insolvent? Your  
3 creditworthiness is based on the strength of the IOUs who  
4 are your customers?

5 MR. REGAN: That is correct.

6 ASSEMBLYMAN WRIGHT: I'm suggesting to you that they  
7 may be in trouble on their creditworthiness, one or several  
8 of them. And so you're saying that you don't have a  
9 contingency in the event that something occurs either to  
10 their creditworthiness or their solvency?

11 MR. REGAN: We do, in fact, have credit standards, and  
12 the credit standards are such that our scheduling  
13 coordinators who purchase from us, or purchase through us --  
14 excuse me, are required, if they have an investment credit  
15 rating below A-1 -- A-2 P-2, which is a short-term  
16 commercial grade, if they are below that, they have to, in  
17 fact, keep posted with us approximately 90 days' worth of  
18 their transactions. And if they do have an investment grade  
19 of A-2 P-2, that is not necessary.

20 As of right now each of the IOUs has that A-2 P-2  
21 rating. So should their credit ratings drop either below  
22 A-2 P-2, which is a short-term rating, or below A, the  
23 long-term rating, then they would be required to post bonds  
24 or post a deposit with us to cover our requirements.

25 ASSEMBLYMAN WRIGHT: So your contingency, then, is

1     that in the event they drop below that figure, then you  
2     would just require them to, in effect, pay in front?

3             MR. REGAN:   That's correct.

4             SENATOR BOWEN:  I don't know that we have a  
5     discussion.  That begins a discussion.

6             ASSEMBLYMAN WRIGHT:  That indicated number projects  
7     forward awfully large.

8             SENATOR BOWEN:  I mean, if you've got an IOU whose  
9     credit rating is dropping, what's the likelihood that  
10    they're going to be able to pay a significant amount of  
11    deposit up front?  I'd suggest it's somewhere close to zero.

12            MR. LEIBER:  In fact, they don't have to actually put  
13    up a cash deposit, but there are other mechanisms that they  
14    can use to establish their creditworthiness.  The most  
15    typical method --

16            SENATOR BOWEN:  I think we're trying to ask what  
17    happens if we're in a situation where the IOUs are no longer  
18    creditworthy?  At least, that's the question I have.  That's  
19    a possibility.

20            MR. LEIBER:  If there is an immediate downgrade, what  
21    they would have to do is to go out and get backing from a  
22    financial institution that would be willing to provide that.  
23    If things really got bad --

24            ASSEMBLYMAN WRIGHT:  He couldn't do that last month.  
25    I mean, I don't know if you're keeping score, but he

1 already -- there are a couple of them that already can't  
2 raise the money with their existing credit ratings. There  
3 is a potential that the existing credit rating will be less  
4 than it was when he was trying to get money before and  
5 couldn't get it.

6       So I'm suggesting that there is a good possibility  
7 that he will, in fact, January 18, 19, see himself go into  
8 the BB category. And it's kind of like it's interesting,  
9 because you would ask him to post a bond, which would mean  
10 he would need more cash, and the fact that he was BB means  
11 that he wouldn't be able to get cash. So you would put him  
12 in the untenable position of requiring an up-front cash  
13 requirement, and he couldn't get the cash when he had the  
14 better credit rating.

15       I'm not sure what the solution is. What I'm saying is  
16 that I'm a little uncomfortable that that eventuality is  
17 beginning to loom on the horizon. Up to and including, by  
18 the way, if I were the management of some of the IOUs, I  
19 would begin looking at an insolvency structure. Because at  
20 some point, in the event there is not some resolution of the  
21 debt that you're carrying, they might consider saying,  
22 whether or not we let a lot of this go in, let Judge Wapner  
23 become the operator.

24       MR. REGAN: Your point, Assemblyman Wright, is not  
25 lost on us. It is one that we have been very much aware of

1 and have been, I guess, looking for solutions. I think  
2 there are several additional points that would have to be  
3 made.

4 I suggested earlier that there were two aspects of it.  
5 One was the fact we have 70 days in which we collect, takes  
6 to convert a delivery of electron into cash. Second is the  
7 increase in price. Third is the fact that over time, over  
8 the past several months, the amount at which electricity  
9 that has been purchased through -- not by, but through the  
10 ISO has increased considerably, from the 5 percent the ISO  
11 was originally designed to be to some 25 to 30 percent of  
12 the daily load.

13 But I think it is also very key to point out that it  
14 is purchased through the ISO. It is not the ISO itself that  
15 goes out and purchases that power, but we purchase it for  
16 the account of load. They are the ultimate obligor. And  
17 that is recognized by the generators when they, in fact, do  
18 supply it, that the ISO does not have a credit standing,  
19 does not have a creditworthiness in terms of its ability to  
20 pay for electricity. But our ability to pay is solely tied  
21 to the tariff obligations of load to meet their -- pay their  
22 bills when provided to them.

23 The ISO does not have any standard, any assets or  
24 financial strength by which it can, in fact, make these  
25 payments. Its only ability -- resort is back to load

1     itself, and that is as supported by the tariff.

2             ASSEMBLYMAN WRIGHT:   So in the event, then -- I mean,

3     it goes back to one of the questions I had.

4             Sorry.   Do you have another question?

5             CHAIRMAN KAHN:   I thought you were doing pretty well.

6             ASSEMBLYMAN WRIGHT:   I went to one of those schools

7     where if you didn't get permission, the teacher had a ruler.

8             CHAIRMAN KAHN:   I have no ruler, Assemblyman.

9             ASSEMBLYMAN WRIGHT:   One of the things that we were

10    describing earlier was that we in California are providing

11    more service.   So if I'm a generator or if I'm a ratepayer

12    and I'm paying, what is it -- \$30? -- and I'm paying

13    slightly more, one of the assumptions that I would make is

14    that you would be in some way participating.   If the deal

15    went sideways, and let's say that, God forbid, one of the

16    IOUs defaulted on a payment, one of the things that is

17    suggested in all the creditworthiness and the other things

18    we do is that you, the ISO, would try to say, you know,

19    since you were going to write the check and you didn't get

20    it, then if I was the generator, I would say, "Well, I've

21    been getting the check from you.   You have been the one who

22    has been pursuing this.   Are you now telling me, 'I didn't

23    get the money from them, so you go pursue them directly'?"

24             Example:   Let's say you're -- and I guess it could

25    become really complicated, because people don't, through



1    you, make direct purchase contracts for the power.  So you  
2    could have seven generators who are owed a percentage of  
3    money from one of the IOUs.  Each of those IOUs would be  
4    looking to you for their money.  You come up short with a  
5    portion of it.  You don't have any credit, and you don't  
6    maintain or assume any obligation.  So you would then, in  
7    effect, become a creditor of the IOU, right?  Because you  
8    would bill them.  If I go bankrupt, then you would too  
9    become a creditor, and you'd have to stand in line along  
10   with all of the other creditors that they had.

11           I'm not a bankruptcy lawyer.  There is probably one  
12   here who is better than me.  But my concern is that we're  
13   not thinking far enough down the road for an eventuality  
14   that could occur.  I mean, I don't know that somebody would  
15   have said that gas was going to be, I think, \$50 or  
16   something, as it got to the other day.  But if we are not  
17   thinking far enough down the road, that could become an  
18   eventuality.

19           And it would then complicate it even more if one of  
20   the IOUs that does, in fact, default, if you're not able to  
21   supply the electricity, then that means that you have to  
22   shut down the electric service to the region or the  
23   franchise area that that IOU had.  Let's say that it was  
24   PG&E.  That means that you'd make San Francisco go dark  
25   because their IOU was insolvent and unable to purchase the

1 power that they had on-line.

2 So what becomes a contingency? Do you as the ISO say,

3 "It is important not only to keep the lights on for the

4 grid, but it is also important that Santa Clara County and

5 San Francisco County and Marin and San wherever else that

6 that IOU serves." But you're saying, "Well, you know what?

7 PG&E was your IOU. They defaulted, so you're S.O.L."

8 I mean, I don't know that that would be an option that

9 you'd get to do. So I'm suggesting that it might be that we

10 begin thinking like a crisis plan as to what happens if that

11 happens. I don't know that it does. But I'm not as

12 confident as perhaps some that that's not something that

13 looms on the horizon.

14 CHAIRMAN KAHN: S.O.L. is spelled I-O-U without fuel.

15 ASSEMBLYMAN WRIGHT: Right.

16 MR. REGAN: Assemblyman, your point is well made. We

17 have, in fact, looked at other options. We have explored

18 the fifth possibility and will continue to do so. We have

19 explored the possibility of obtaining bonding. We have

20 found that to be -- we've had headlight quotes. The

21 challenge, I think, is we are seeing our receivables or our

22 throughput increasing by a factor of six to eight when, in

23 fact, the IOUs are buying through the ISO, as opposed to

24 buying directly.

25 CHAIRMAN KAHN: I think I have an observation about

1     this. I think Assemblyman Wright asks a lot of good  
2     questions, and I think there are other good questions to be  
3     asked. But the fundamental issue is if you are thinking  
4     about these things, are you communicating it to this Board  
5     and on a realtime basis? Because Assemblyman Wright's  
6     analysis of this, taken to logical extension, has dire  
7     implications. And I think that you are obligated to advise  
8     us of the status, again, on a realtime basis of what's  
9     happening, so that not only the EOB regular members but the  
10    legislative members can be apprised of the state of the  
11    situation.

12           Can I get an agreement that you'll do that?

13           MR. ROBINSON: Absolutely. We have been looking into  
14    it. We continue to do so. We recognize the need to  
15    accelerate our efforts and, frankly, we welcome the  
16    participation of the EOB or other state policy makers in  
17    finding a solution.

18           CHAIRMAN KAHN: Well, if you folks on the firing line  
19    are feeling the credit crunch and are developing information  
20    about the economical liability of the system, I think you  
21    are obligated to tell us as soon as you can so that we can  
22    take whatever steps are necessary. And now I'm talking  
23    about "we," the State of California.

24           But given the scheme that's been established, you have  
25    a unique window into the financial viability of this system.

1 And since you have that unique window, the only way that we  
2 will be able to look through it is if you tell us. So I  
3 think this is a very important area of input.

4 MR. ROBINSON: That's agreed to.

5 CHAIRMAN KAHN: Why don't you go on ahead, unless  
6 anybody wants to -- Senator?

7 SENATOR BOWEN: There's one more thing. The Los  
8 Angeles Times ran an article this morning talking about the  
9 power industry's refusal to sell -- extend credit to the ISO  
10 in the last two days. And so this is not a -- this is not  
11 an inquiry that's academic.

12 MR. REGAN: That's correct.

13 SENATOR BOWEN: And I think the comment about  
14 securitizing receivables and financing it, you know, I think  
15 that one Californian who is in that business has been  
16 precluded by SEC to offer bonds of that quality any longer.  
17 And I would suggest to you that probably the only entity  
18 that has the kind of credit financing that would be needed  
19 to get you out of this and to get ratepayers of these  
20 industrial utilities out of it is the State of California.  
21 It's ultimately our credit that's going to be on the line to  
22 keep the lights on.

23 And, you know, it's the reason that when I get reports  
24 that some group in San JosÈ decided not to turn off their  
25 Christmas lights last night, you know, I understand that

1 people don't want to have to deal with this. It's not the  
2 time of year when we want to have to deal with this. But we  
3 could have a real meltdown. And we need to have the ISO,  
4 you know, talking to us about what exactly a plan will be,  
5 because we can't just put together financing to make this  
6 happen overnight.

7 So I just think we need to have a contingency plan.

8 Well, what happens if there are more power exits and  
9 there are more refusals to sell to the ISO, and we start --  
10 the system starts coming apart if that happens, don't you  
11 think?

12 I mean, what does your system look like if those kinds  
13 of things become, you know, if half the generators refuse to  
14 offer credit for a certain ISO, how many people at the ISO  
15 does it take, then, to facilitate the direct purchase?

16 MR. REGAN: If the challenge that you are putting  
17 forward, Senator Bowen, is in working with the generators to  
18 help them understand where the credit is coming from and  
19 that the ultimate credit -- we are a throughput. The  
20 ultimate credit is, in fact, load, the IOUs, and the people  
21 of California.

22 CHAIRMAN KAHN: Well, that's --

23 SENATOR BOWEN: But, right, it's the people of  
24 California. It will only be that way if we take some action  
25 in the Executive Branch or the Legislature to make that

1    happen. Right now the State of California is not on the  
2    hook for any of this.

3           CHAIRMAN KAHN: That's right. And the challenge is to  
4    provide realtime information to the Legislature and to the  
5    Governor so that we can make policy decisions. And not only  
6    do you have to tell us what's going on in realtime, but you  
7    also have to tell us, as the Senator points out, what you  
8    are capable of doing with respect to it.

9           We have a couple of other agenda items, and we don't  
10   have that much more time to pursue them.

11          MR. ROBINSON: If I could just make one comment. I  
12   didn't want you to be left with the impression that we have  
13   not been advising the State of some of these issues. For  
14   example, the particular issue that Senator Bowen referenced,  
15   we have actually been in communication with representatives  
16   of the State about.

17          CHAIRMAN KAHN: We weren't saying you weren't doing  
18   it. We were saying we'd like you to do more.

19          MR. ROBINSON: I understand.

20          MR. REGAN: This particular instance is a one-event  
21   instance, and it's been two days brewing. And we believe  
22   that it is primarily being driven by the generator, by the  
23   market, and that entity's exposure, as opposed to the  
24   creditworthiness on the other side.

25          CHAIRMAN KAHN: That's what somebody told me in May

1    when the prices were that high, it was just a one-time  
2    thing.

3           Assemblyman?

4           ASSEMBLYMAN WRIGHT:  I think, you know, again, as I  
5    look at the process that we have here, one of the things  
6    that has been discussed on the legislative side as we're  
7    preparing to do budget, we're setting aside some money.  As  
8    I'm listening to what you say, then the concept of having  
9    some contingency money makes real good sense.  And I think  
10   that it would be, you know, very helpful for us if you  
11   analyzed, for example, the one IOU that went under a  
12   billion 2 in November.  That's a lot of cash.

13          MR. REGAN:  Yes, sir.

14          ASSEMBLYMAN WRIGHT:  So, if the numbers at which we  
15   are describing the fees are that severe, I think that there  
16   are a number of things that I think you might need to be  
17   prepared to do.  One of which might be to look at capital on  
18   kind of a bridge where, you know, there might be a loan.

19          The reality is as well that there is still ratepayer  
20   money that would be collected and some other things if there  
21   was a default.  It's not as though all the money goes away.  
22   But I'm saying that at the end of the day, I will bet you a  
23   dollar that it would not be acceptable to say to the people  
24   in the Edison region or the SDG&E region or the PG&E region  
25   that your IOU is insolvent, therefore, you have no lights.

1           So, since that's not an option, then I would suggest  
2   that we come up with options of both financing and operating  
3   the system on a contingency if that occurs. I mean, it  
4   might well be that since -- I'm not a lawyer, but if I was  
5   the person that was buying power from you, and you told me  
6   that the other guy didn't pay you, I'd go, "Then you are on  
7   the hook for money from somebody, because you were the one  
8   operating in the middle, and it was your responsibility to  
9   see that they covered it."

10           I would suggest that your lag time allows a whole lot  
11   of time for people to, in effect, be gone. And there's  
12   another thing that could happen to just complicate it  
13   further, is that there might be other people who would be  
14   creditors in line for the cash from that IOU if that  
15   occurred.

16           I think that there needs to be a significant  
17   contingency plan that you do, because, in the end, you might  
18   become the operator of last resort to try to maintain such  
19   systems and other kinds of things.

20           And I say it to you because there is probably nobody  
21   else in the position to at least see that the load moves  
22   through. And I think that your contingency plan needs to be  
23   substantially broader than you're currently laying out here.

24           MR. ROBINSON: We will report back to you at the next  
25   meeting on such a plan, and continue ongoing discussions



1 with you as things arise.

2 CHAIRMAN KAHN: And you can be sure that one of us --

3 MR. ROBINSON: I expected as much.

4 CHAIRMAN KAHN: -- from the EOB well be in touch with

5 you next week to talk about this.

6 Is there anything else on the budget you wanted to

7 present?

8 MR. REGAN: No, sir. That's fine.

9 MR. WILLISON: Can I raise -- I'm sorry to raise a

10 mundane question after that last discussion, but you can't

11 help but notice the 20 percent increase in head count, the

12 34 percent increase in average salaries. And I guess I

13 would just hope that given the uncertainty with regard to

14 the ISO, the structure and the functions of the ISO going

15 forward, that your Board would show a lot of restraint in

16 terms of moving forward on those additional people or those

17 additional increases, which would appear to be way above

18 market increases, before you actually do it.

19 MR. LEIBER: Some of the rough analysis that's been

20 performed on our budget does require some clarification.

21 There is no 11 percent increase for existing employees. It

22 is much more in line with what we're seeing in the market.

23 The average employee will receive an approximate 4 percent

24 increase. The 11 percent that appears here is due to other

25 factors. For example, salaries and benefits includes

1 relocation expenses. So there are some other items that  
2 will account for that apparent 11 percent increase.

3 CHAIRMAN KAHN: Okay. If there are no further  
4 questions.

5 Oh, one more.

6 SENATOR BOWEN: I think given the kind of discussion  
7 we've had, I want to suggest to you in the strongest terms  
8 that you put plans for building another headquarters on hold  
9 immediately. I know there are some people in this room who  
10 were here in 1993, and many of them may recollect a time  
11 when the state was in recession and the South Coast Air  
12 Quality Management District was building what many termed  
13 the Taj Mahal in Diamond Bar, an elaborate new headquarters  
14 that was intended to and, in fact, has saved them a  
15 significant amount of money.

16 The Legislature spent much of that year struggling  
17 with attempts to revoke the charter of the South Coast Air  
18 Quality Management District because it had the poor judgment  
19 to undertake a capital spending program at a time when the  
20 people it was regulating were suffering extraordinary pain.  
21 There were layoffs, business closures, the state was in  
22 recession, and the public backlash and business backlash was  
23 extraordinary.

24 I hope that you will perceive, with the capital  
25 expenditure program, regardless of whether you'll save the

1 money in the long term, you will suffer much the same fate,  
2 if not a worse one. Ultimately, the South Coast Air Quality  
3 Management District was saved by the fact there is a federal  
4 air mandate to achieve certain emissions reductions, but  
5 there were restrictions placed on how much fees could be  
6 increased. And a whole series of legislative actions were  
7 taken to make it more difficult for the South Coast to do  
8 certain things.

9 I think the backlash here, when you see people's  
10 energy bills have increased 2- to 300 percent in the last  
11 year, and when you're dealing with under-collections of the  
12 magnitude that we are seeing with PG&E and other  
13 territories, the kind of backlash that you will get if you  
14 proceed to build new headquarters at this moment, I think  
15 will astonish you. And I would urge you to take a look at  
16 your budget for every capital expenditure and ask yourself:  
17 In this current year, with power prices going where they  
18 are, should we be doing that kind of capital outlay, or  
19 should we be investing in, let's say, a refrigerator  
20 crunching program, to go out and collect all pre-1996  
21 refrigerators, pay the owners 75 bucks to turn them in?  
22 Let's work with the county EPA to deal with the freon  
23 problem; and bring down demand in the long-term and in the  
24 short-term by using some of that capital expenditure.

25 When I look at the budgetary proposals for new costs

1 plus contracts, and you look at the cost of natural gas, I  
2 have to ask the same kinds of questions.

3 All those are going to do are get us through the next  
4 few months, and I know we have to do that. But we had  
5 discussions last February about CalISO's ability to work on  
6 the demand side. And pursuing any capital expenditure at  
7 this point, I think it ought to be on bringing rates down,  
8 and just postpone anything else that's not absolutely  
9 necessary for the next couple of budget years until we solve  
10 this problem.

11 CHAIRMAN KAHN: I'd like to change the subject if  
12 we're done with the budget. And, Mr. Robinson, I have an  
13 inquiry for you.

14 FERC has asked you to undertake some activities with  
15 respect to your board of directors. Can you tell me what is  
16 the earliest -- and I understand that the ISO is, in fact,  
17 cooperating with the FERC in their request. Is that right?

18 MR. ROBINSON: I wouldn't characterize it in that  
19 fashion, Chairman Kahn. What I would say is that we've  
20 begun some preliminary inquiries to identify the potential  
21 candidates for board positions, that we have sent out an  
22 offer to the State to have participation in the selection  
23 from a board slate. I think that from the ISO's  
24 perspective, we continue to believe that substantial state  
25 input is not only desirable, but necessary, and that there

1     should be some sort of agreement between the federal  
2     agencies and the state on the ISO board.

3             So what we have done at this point is preliminary. It  
4     is not intended to suggest that we intend to ignore what we  
5     understand the State's concerns to be.

6             CHAIRMAN KAHN: I appreciate that. And you're right.  
7     I agree with the present amendment of my characterization.

8             What I'm really getting at, and what is important to  
9     the State, is the Governor has made his position pretty  
10    clear. And I think there has been a bill introduced in the  
11    Senate with respect to the ISO, or will be shortly. What we  
12    want to know from the ISO is what steps you are taking.

13            You have told me what you've taken thus far, but if  
14    you take other steps with respect to implementing the first  
15    directive, including nominating and actually selecting such  
16    directors or to seat them, we would like to know when you're  
17    taking those steps, and we'd like to know in advance of your  
18    doing it.

19            I agree with you, and I think it's the Governor's  
20    position that the federal government and state government  
21    ought to work together to solve this problem. On the other  
22    hand, since you are in the middle and at this point in time  
23    you still come to our meetings, I am telling you that we  
24    want to know from you what your timetable is in respect to  
25    FERC, so that if the Legislature or the Governor should

1     decide to take action, that they'll have enough time to plan  
2     that.

3             I raise that in context of Senator Bowen's comments.  
4     I think Senator Bowen made very important observations to  
5     you. The only problem with Senator Bowen's comments is that  
6     we're not sure what board of directors to address it to.

7             Certainly, everyone agrees the current board in one  
8     form or another is a lame duck board. But we don't know who  
9     the coming board is. And I think that steps taken in  
10    derivation of Senator Bowen's observations in the current  
11    context, all we do know for sure is that if the current  
12    board is not going to keep its status would be problematic.

13            So we just appreciate your cooperation. We obviously  
14    understand that you're caught in the middle here and it's no  
15    fun, but on the other hand, what will be most upsetting more  
16    than anything else is having actions taken with respect to  
17    the ISO board of directors that we are not given full notice  
18    of so we can take whatever steps we need to take whenever  
19    necessary.

20            Thank you very much for your cooperation and your  
21    help, and we look forward to working with you on your budget  
22    matter and cooperating with you on any other matter.

23            MR. SALTMARSH: Mr. Chairman?

24            CHAIRMAN KAHN: Yes, Mr. Saltmarsh.

25            MR. SALTMARSH: If you would indulge me, I would like

1 to request whether it would be possible to get to the ISO,  
2 off-line, probably a little bit of a clarification on the  
3 issues surrounding the need in the ISO's mind for the  
4 upgrade or replacement of the energy management system.

5 I am struck that in my travels around the country, I  
6 am commonly in parts of the country where a particular  
7 vendor still advertises on television and radio that when  
8 California needed a new, cutting-edge power management  
9 system to manage their electricity structure, they came to  
10 us, and we're on the cutting edge of this.

11 I realize that the people actually at this table  
12 inherited a lot of this development from your predecessors  
13 in interest, but I would be particularly interested in  
14 knowing whether from your point of view the energy  
15 management system you're using just didn't work for the task  
16 very well or doesn't work for things that weren't  
17 anticipated at the time that you are doing, or is inadequate  
18 to things that you're not doing now but anticipate you'll be  
19 doing, and what those might be.

20 MR. LEIBER: Mr. Saltmarsh --

21 CHAIRMAN KAHN: If in your opinion it is more  
22 appropriate to do that off-line, you can do it.

23 We'll take a short answer now or a long one later.

24 MR. LEIBER: The system that we have was an old one.  
25 It is no longer a supported product by that vendor, and we

1     can give you some more details about this.

2             CHAIRMAN KAHN:   Are you the person that Mr. Saltmarsh  
3     should call?

4             MR. LEIBER:   Myself, or Dennis Fishback is probably  
5     the more appropriate.

6             CHAIRMAN KAHN:   Okay.   Thank you.

7             Mr. Heath, what else do we have?

8             MR. HEATH:   We have two other items, Mr. Chairman.

9             Given the time, I would like perhaps for the Board to  
10    consider taking up Item 5-C.   And if it's okay with you and  
11    with the Board, I'd like to go over Item 5-D.   And 5-D is a  
12    report on the 10-minute settlement.

13            In your packet you have a number of letters that were  
14    submitted by various parties objecting to some of the issues  
15    on the 10-minute settlement.   If you recall, at previous  
16    board meetings this issue came up.   The ISO was to report  
17    back to EOB on the 10-minute settlement program.   This was  
18    the day they were going to do that.   But if we could put  
19    that over, and we'll convene some sort of working group on  
20    that and get a report back to you.

21            CHAIRMAN KAHN:   That's fine with me.   Do you have some  
22    objection?

23            MR. ROBINSON:   I'm sorry?

24            CHAIRMAN KAHN:   That's okay.   Mr. Heath was suggesting  
25    that discussion of the 10-minute settlement be put over.



1           MR. ROBINSON: I think that's fine.

2           CHAIRMAN KAHN: Is that a problem?

3           MR. ROBINSON: That's no problem.

4           CHAIRMAN KAHN: I didn't think so.

5           So the last thing we want to talk about is the \$100

6 rate.

7           MR. HEATH: That's correct.

8           CHAIRMAN KAHN: I think that's a subject matter that

9 is interesting to many of us.

10          Welcome. Would you be kind enough to introduce

11 yourself.

12          MS. SHEFFRIN: Yes. Good morning, Chairman Kahn and

13 members of the committee. My name is Angela Shepherd. I am

14 the Director of Market Analysis at the California ISO.

15          CHAIRMAN KAHN: Before you begin, I have a question.

16 And this is that we have heard a lot of testimony and

17 statements in the last three or four months that the \$250

18 cap, in fact, was dysfunctional because it had caused rates

19 to rise. And we were handed a whole bunch of charts that

20 showed us that what happened was the price gravitated to the

21 cap.

22          In the last few days we have had the price at the cap.

23 For quite a while we've actually had fleeing from the market

24 to try to grab higher prices. Would you agree with me that,

25 at least recently, that the price cap has held prices? As

1     horrible as they are, it has still nevertheless held them to  
2     a lower rate than they otherwise would have been?

3             MS. SHEFFRIN:   Yes, I would.

4             CHAIRMAN KAHN:   Thank you.

5             Mr. Saltmarsh, pay attention.

6             MR. SALTMARSH:   I am trying.

7             CHAIRMAN KAHN:   Okay.   Go ahead.

8             MS. SHEFFRIN:   What I've been asked to brief you on,  
9     there were two items originally, so slides on a brief  
10    assessment of the 10-minute settlement is part of your  
11    packet.   But since it's been held over, you can look at  
12    those at your leisure, and then we can, you know, answer  
13    some -- any additional questions you have on the 10-minute  
14    settlement.   But they're in the packet for your review.

15            CHAIRMAN KAHN:   Thank you.

16            MS. SHEFFRIN:   We have been asked to address the  
17    Assembly Bill, Joint Resolution 77, which asks the ISO to  
18    consider or look at the feasibility of lowering the price  
19    cap on ancillary service markets to a hundred dollars.   I  
20    would note that in August we did lower the replacement  
21    reserve price cap to \$100.   We kept the realtime energy  
22    price, as well as other three ancillary service prices, at  
23    \$250.

24            On November 15th our authority to change price caps  
25    expired, and FERC, in its order, essentially said that

1 prices -- the price cap will stay at \$250 until the end of  
2 the year unless they ask. So we do not currently have the  
3 authority to change our price cap.

4 CHAIRMAN KAHN: What do you think would happen if the  
5 price cap were eliminated this week?

6 MS. SHEFFRIN: I guess I'm not here to discuss with  
7 you eliminating the price cap. I don't think that's ever  
8 been our position.

9 CHAIRMAN KAHN: I know that.

10 MS. SHEFFRIN: We feel price cap in any market is  
11 prudent. It's just a question of what level it should be  
12 set.

13 CHAIRMAN KAHN: Right. But there is a debate going  
14 on, and there was a debate at FERC between the Governor and  
15 FERC in which the Governor asserted that price caps were  
16 necessary, and FERC said that they weren't going to  
17 acquiesce in that deal.

18 We have now a report due or, on December 13th, a  
19 meeting with FERC. It seems to me that we have an emergency  
20 situation in California, and the appropriate thing to do  
21 would be if the ISO sees that we would have a worse  
22 situation yet in California in the first week in December if  
23 there wasn't a 250 cap, it seems to me the ISO should be  
24 making an emergency filing at FERC to apprise FERC of what's  
25 happened in the last week, and to tell FERC that if they do

1    what they're planning to do, and that is on January 1 we  
2    eliminate all price-cap authority, that we could be in an  
3    incredibly worse situation.

4           MS. SHEFFRIN:  Again, it is not my understanding  
5    beyond one member of FERC that they were talking about  
6    removing price caps.  But we do apprise FERC regularly of  
7    what's happening in our market.  And they just called me at  
8    7:00 a.m. this morning to tell me that they are going to  
9    enter into and help out in the investigation of the power  
10   plant outages.  So we do keep them apprised of what's  
11   happening in our market on a regular basis.

12          CHAIRMAN KAHN:  Just one split for a second.

13          Mr. Robinson, I would request on behalf of EOB that  
14   the circumstances of the last week have been so dire and  
15   extraordinary that the ISO take whatever steps are necessary  
16   to immediately advise FERC of the situation so that they  
17   don't cause further peril to California by their actions up  
18   to January 1.

19          MR. ROBINSON:  We've been in contact with FERC on a  
20   daily basis and, in fact, multiple times during the days  
21   this past week.

22          CHAIRMAN KAHN:  Right.  I know you've talked about  
23   reliability, but price is on my mind at the moment.

24          MR. ROBINSON:  We have referenced price once or twice  
25   in those conversations.

1           CHAIRMAN KAHN:   Okay.   Assemblyman Wright?

2           ASSEMBLYMAN WRIGHT:   I think there are a couple of  
3   things that come to mind.   If I took the price of gas today,  
4   you couldn't produce gas for 250 at the current -- you  
5   couldn't produce electricity for 250 at the current cost of  
6   gas.   And where you have to be careful with some of the  
7   people with whom we're dealing is, under the old paradigm, a  
8   company would produce electricity because they were required  
9   to do that because they were regulated to do that.

10          If I was a company that had, say, a three- or  
11   four-dollar gas contract, and my gas was selling for \$50, if  
12   my electricity was selling for 250, you've just put me in  
13   the gas business.   I ain't in the electric business no more.

14          MS. SHEFFRIN:   Right.

15          ASSEMBLYMAN WRIGHT:   Because suddenly the commodity of  
16   gas is worth so much more than electricity at 250, then I'm  
17   not going to be there.

18          The last number that I got from yesterday is that the  
19   gas cost today is somewhere around 350 to \$400 per kilowatt.  
20   That's how much it costs to make it.   And if I layer on top  
21   of that the NOx costs that go with it, there are a whole lot  
22   of power plants that are finding that -- particularly those  
23   guys who have long-term gas contracts -- they're discovering  
24   that they ain't in the electric business anymore.

25          So I'm thinking it's a double-edged sword as we begin

1 to look. I mean, I would suggest that if gas stays in the  
2 plus-30, 40, \$50 range, a hundred dollar price cap is like  
3 it's great if you can get it, but I mean --

4 MS. SHEFFRIN: The question is: Where can you get it?

5 ASSEMBLYMAN WRIGHT: -- that wouldn't be possible  
6 unless you found somebody who had long-term contracts at a  
7 low price who was prepared to take it at less than that.

8 I think -- I mean, I haven't seen all the technology,  
9 but at \$50 a barrel -- or strike that -- at \$50 per cubic  
10 foot, that's damn near like 200-and-something, 200 or \$300  
11 like a barrel of oil.

12 I think we may have to look at the contingency of  
13 saying in some of these plants the ability to run either on  
14 natural gas or oil is a possibility. There may be  
15 technology with the scrubbers and other things to get the  
16 plants back to running on oil. But suddenly -- I mean,  
17 we're going to fool around in a minute and make a whole lot  
18 of stuff possible.

19 I remember when we were here talking about QF  
20 contracts and how uneconomic they were. Even the nuclear  
21 plants are running economically now. So, I mean, I'm saying  
22 that, you know, it's difficult to say. And when you say  
23 should we keep a price cap and not do those things, we need  
24 more discussion, because it causes other things to happen.  
25 What you've just done at that point is you've pushed your

1 finger in the balloon, but that applies pressure to other  
2 portions of the balloon. So it may or may not get you the  
3 desired result. What you may have just succeeded in doing  
4 is putting your finger in the balloon and making a dent  
5 where your finger went in.

6 I'm not sure that at this point it's prudent to  
7 maintain 250s. If you can't produce the electricity for  
8 that, then it would probably be considered somewhat  
9 foolish.

10 At the same time, you can make an argument that if you  
11 put the price cap in at whatever price cap you put it, it  
12 could even come forward with an unintended consequence. Or,  
13 if you don't have a cap, then people just gouge the process  
14 and they run it up to the top.

15 I mean, the unfortunate reality is that, you know, you  
16 have to be careful in this consequence that the perfect  
17 doesn't become the enemy of the good.

18 There is no ideal solution, and probably the worst  
19 thing that you can do is nothing. So, I mean, I think we  
20 have to develop a strategy, to decide on it, and then go  
21 that way. And once we decide on that strategy, then I think  
22 you go, and then you have to let all of the other  
23 considerations fall by.

24 There will always be the ability to look back and say  
25 we could have had and we should have had and we might have

1 had. But if you don't choose, then that's a decision as  
2 well. Not you. But I'm just saying for all of us who make  
3 policies.

4 MS. SHEFFRIN: But at minimum, the price cap has to  
5 cover the cost of production, and right now gas prices,  
6 where they are -- that was the point of my first bullet --  
7 is system -- when I wrote this slide it was a day ago, it  
8 was 35 dollars a million BTU of gas. Now they're quoting 45  
9 to \$50.

10 If you multiply that by a typical gas-fired unit of  
11 10,000 heat rate, that's 400 to \$450 just for fuel. So it's  
12 exactly as Mr. Wright has talked about. We have to cover  
13 the cost of production or, you know, nobody is going to  
14 operate at a loss to produce electricity, and you're only  
15 going to aggravate the shortages.

16 MR. WILLISON: Do we track the prices in other markets  
17 that import power?

18 MS. SHEFFRIN: Yes, we do. We track Palo Verde,  
19 that's the southwest prices, the California-Oregon border,  
20 and Mid-Columbia, which is in the northwest.

21 MR. WILLISON: And what's happening in those markets?

22 MS. SHEFFRIN: Again, this is off the top of my head,  
23 but I believe prices are trading anywhere between 600 and  
24 \$800 in the northwest. Things in the southwest are more  
25 around 350 to \$450.



1           CHAIRMAN KAHN:   Mr. Rozsa?

2           MR. ROZSA:   On the high gas prices, I have been  
3   reading stories about the reason for these gas prices is not  
4   because of a chronic problem, but because El Paso Natural  
5   Gas is withholding capacity on the pipelines to the  
6   Southwest, so that these gas prices are, themselves, subject  
7   to some sort of manipulation.   And yet when making  
8   calculations here about the price cap predicated upon gas  
9   prices which appear to be distorted themselves, that  
10   concerns me that we're, you know, assuming that the price of  
11   gas now is not a distorted price.

12           We are treating it as if it were real and not an  
13   artifact of illegal activity, which I believe the PUC has  
14   claimed and have complained at FERC.   That sort of concerns  
15   me that we use this as a predicate for talking about what's  
16   a reasonable price cap.

17           MS. SHEFFRIN:   My understanding is that, yes, the CPUC  
18   has complained at FERC, and San Diego Gas & Electric filed  
19   for price caps on natural gas.   But when I make these  
20   calculations again, it's to reflect the current market and  
21   the fact that the market is regional, so supply will go to  
22   the highest bidder.

23           MR. ROZSA:   That's true.   But you're using what  
24   appears to be a distorted price of gas to make your point.

25           MS. SHEFFRIN:   Nothing has been done to curb those gas

1 prices yet.

2 MR. ROZSA: Has the ISO --

3 MS. SHEFFRIN: The ISO is not in the gas business,  
4 thank God.

5 MR. ROZSA: That's my point. But that's important.

6 MS. SHEFFRIN: Right.

7 MR. ROZSA: Because it might be more judicious to base  
8 it upon the wellhead cost of gas plus a normal markup for  
9 transportation, as it is elsewhere in the country, than to  
10 look at what's a reasonable price cap.

11 CHAIRMAN KAHN: We're running out of our allotted  
12 time. So why don't you tell us what other points you think  
13 are important.

14 MS. SHEFFRIN: Excuse me?

15 CHAIRMAN KAHN: Tell us the other things you think  
16 it's important for us to know.

17 MS. SHEFFRIN: Just looking at the price cap of the  
18 margin cost to produce and the fact that -- as Mr. Wright  
19 already made my point -- lowering the price cap could, in  
20 fact, create additional shortages, because it would reduce  
21 the power offered for sale both here as well as what we  
22 would have to be able to import to meet our needs. Again,  
23 remember, we are a net importer of our power needs, and so  
24 we have to compete with everybody else in order to attract  
25 those power suppliers into the California state.

1           CHAIRMAN KAHN: Thank you.

2           Mr. Heath, are we done with our agenda?

3           MR. HEATH: We are done with the agenda, and I think,

4 Mr. Chairman, we have meetings scheduled in a few minutes.

5           CHAIRMAN KAHN: I'll take a motion to adjourn.

6           MR. ROBINSON: Chairman Kahn?

7           CHAIRMAN KAHN: Yes, sir.

8           MR. ROBINSON: I'm sorry. I did want to note one

9 thing for the record. I wanted to reiterate what you had

10 started out by saying, and to thank the consumers of

11 California under the leadership of the Governor and of this

12 Board in reducing their demand during the past week. We

13 noted on Tuesday that we reduced -- that it appeared there

14 was a conservation in the amount of 1300 megawatts, which is

15 approximately the equivalent of 1.3 million homes. So I

16 think the message got out largely through the efforts of the

17 State and through the media. We appreciate it, and we'll

18 need it for the next week coming up.

19           CHAIRMAN KAHN: Mr. Robinson, your comments are

20 absolutely well taken. The more we can say that to the

21 press and in getting the message out, the better we all will

22 be.

23           MR. SALTMARSH: Mr. Chairman?

24           CHAIRMAN KAHN: Yes.

25           MR. SALTMARSH: Before the meeting is finally

1 adjourned, I note that we have moved through all the action  
2 items that were identified, but we have not received any  
3 formal requests. There is an agenda item for possible  
4 public participation, and I would ask if we could just  
5 confirm whether anyone had hoped to do that. And I don't  
6 know whether it can be accommodated or not.

7 CHAIRMAN KAHN: Seeing none, I will call the question.

8 All in favor?

9 THE MEMBERS: Aye.

10 CHAIRMAN KAHN: Thank you very much everybody.

11 (At 11:55 the meeting was adjourned.)

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